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FISCAL IMPACT STATEMENT

LS 7049
BILL NUMBER: HB 1545

NOTE PREPARED: Apr 10, 2013
BILL AMENDED: Apr 9, 2013

SUBJECT: Tax Credits.

FIRST AUTHOR: Rep. Turner
FIRST SPONSOR: Sen. Hershman

BILL STATUS: As Passed Senate

FUNDS AFFECTED: X **GENERAL**
X **DEDICATED**
FEDERAL

IMPACT: State

Summary of Legislation: The bill contains the following provisions:

Sales Tax Exemption: It provides a sales tax exemption for fuel used in powering an aircraft.

Hoosier Business Investment Tax Credit (HBI): It adds logistics investments as a specific type of qualified investment under the HBI. It specifies in detail the expenditures that qualify as a logistics investment. It requires the Indiana Economic Development Corporation (IEDC) to find that an applicant's logistics investment project will enhance the logistics industry by creating new jobs, preserving existing jobs that otherwise would be lost, increasing wages in Indiana, or improving the overall Indiana economy in order to approve the applicant's project for a tax credit. It makes conforming changes to the credit application and agreement provisions.

The bill provides that the percentage credit maximum is 25% (instead of 10%) if a qualified investment is a logistics investment. Provides that for logistics investments, the qualified investments used to determine the credit are based on growth in qualified investments by the taxpayer using 105% of the investments made by the taxpayer during the immediately preceding two years. It adds a $50 M state fiscal year ceiling for tax credits that are not based on logistics investments. The bill provides a $10 M state fiscal year ceiling for tax credits that are based on logistics investments.

It requires the Department of State Revenue (DOR) to annually report to the Budget Committee on the use of the tax credit for logistics investments.

Income Tax Credits: The bill makes numerous changes to the administration of the Headquarters Relocation Tax Credit, and the Venture Capital Investment Tax Credit. The bill repeals the Military Base Recovery Tax Credit, the Military Base Investment Cost Credit, the Capital Investment Tax Credit, and the Coal Combustion Product Tax Credit. It also repeals the following tax incentives concerning Airport Development Zones (ADZs): (1) Qualified Employee Deductions; (2) credits for Qualified Increased Employment Expenditures; (3) Loan Interest Credits; (4) Neighborhood Assistance Credits; and (5) Investment Cost Credits.

The bill removes two unused definitions.

Effective Date: July 1, 2013; January 1, 2014.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The bill's requirements are within the DOR's routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

Indiana Economic Development Corporation (IEDC): This bill changes the eligibility criteria for the Hoosier Business Investment Tax Credit (HBI), Headquarters Relocation Tax Credit (HQR), Industrial Recovery Tax Credit (IR), and Venture Capital Investment Tax Credit (VCI). The IEDC will be required to modify their evaluation process. The IEDC's current level of staff and resources should be sufficient to implement the provisions in the bill.

Explanation of State Revenues: Summary - This bill establishes a sales exemption for aircraft fuel, changes four state income tax credits and repeals nine other tax credits. The table below shows the estimated revenue impacts of the provisions within the bill.

	FY 2014 ($ in millions)	**FY 2015 ($ in millions)**
Sales Tax Exemption on Aircraft Fuel	($5.40 - $5.60)	($5.77 - $5.97)
Headquarters Relocation Tax Credit	Indeterminable	Indeterminable
Hoosier Business Investment Tax Credit	$0	($10.0)
Industrial Recovery Tax Credit	($1.57)	($1.57)
Venture Capital Investment Tax Credit	$0	$0
Repealing Various Tax Credits*	$0	$0.04
Total	**($6.97 - $7.17)**	**($17.3 - $17.5)**
***Capital Investment Tax Credit, Coal Combustion Product Tax Credit, Military Based Investment Cost Tax Credit, Military Base Recovery Tax Credit, Airport Development Zone (ADZ) Employment Expense Tax Credit, ADZ Investment Cost Credit, ADZ Loan Interest Tax Credit, ADZ Neighborhood Assistance Credit, ADZ Qualified Employee Tax Deduction.**		

The majority of the tax credits may be used to offset tax liabilities from the Individual Adjusted Gross Income Tax, Corporate Adjusted Gross Income Tax, Financial Institutions Tax, and Insurance Premiums Tax. Revenue collected from those taxes is deposited in the state General Fund. Sales Tax collections are currently deposited in the state General Fund (99.848%), the Commuter Rail Service Fund (0.123%), and the Industrial Rail Service Fund (0.029%).

Sales Tax Exemption: Current law exempts aircraft fuel purchases from Sales Tax if the fuel is used in public transportation. This bill would exempt the remainder of aircraft fuel purchases. The table below shows the estimated impact of the exemption on each fund receiving Sales Tax revenue.

Impact on Funds		**Lower Limit Estimate**		**Upper Limit Estimate**	
Fund	**Distribution**	**FY 2014**	**FY 2015**	**FY 2014**	**FY 2015**
General Fund	99.848%	($5,393,304)	($5,763,223)	($5,593,000)	($5,962,919)
Commuter Rail Service Fund	0.123%	(6,644)	(7,100)	(6,890)	(7,346)
Industrial Rail Service Fund	0.029%	(1,566)	(1,674)	(1,624)	(1,732)
Total	**100.000%**	**($5,401,514)**	**($5,771,996)**	**($5,601,514)**	**($5,971,996)**

This provision exempts two major types of fuel: jet fuel and aviation gasoline. Jet fuel is primarily used in large commercial aircraft, while aviation gasoline powers other types of smaller planes. It is estimated that roughly 93.5% of jet fuel and aviation gasoline is likely used in public transportation. It is estimated that the revenue loss associated with jet fuel could potentially total about $5.0 M in FY 2014 and $5.4 M in FY 2015; and the revenue loss associated with aviation gasoline could potentially total about $400,000 to $600,000 annually.

The jet fuel estimate is based on historic state-level consumption and price data compiled by the U.S. Energy Information Administration. The aviation gasoline estimate is based on actual Sales Tax collection data from the DOR for FY 2009 through FY 2012.

Headquarters Relocation Tax Credit (HQR): The bill makes the following changes to the HQR credit:

1. Allows the IEDC to offer the credit at a rate of up to 50% of the taxpayer's relocation costs instead of only at a rate of 50% as under current statute.
2. Lowers the worldwide revenue requirement from $100 M in the prior year to $50 M in the prior year.
3. Expands the definition of a qualifying relocation to include the relocation of a division or subdivision principal office or a research and development center.

The rest of the qualifying conditions of the tax credit would remain the same.

As of September 2012, the IEDC had not approved or authorized any HQR credits. However, these changes expand the number of potential qualifying firms. With the new parameters, an estimated 34,690 additional worldwide firms may qualify for the credit. A study conducted on corporate headquarters migration found that 8% to 10% of the corporate headquarters moved over a 10 year period. Assuming 1% of the potential firms move every year, there may be about 7,320 firms that may qualify for the HQR in any given year. The estimated revenue loss associated from these changes is indeterminable. The actual amount of credit a qualifying business may claim depends on the IEDC. They will make the final determination on the amount of credit awarded.

*Hoosier Business Investment Tax Credit (HBI):*This bill makes changes to the HBI tax credit. It defines a new award criterion for logistics investments, establishes a new credit award tier for logistics investments, and specifies that the current credit award computation applies to nonlogistics investments. The changes are effective for taxable years beginning January 1, 2014. The revenue loss from these changes will likely begin in FY 2015, but could begin in FY 2014 if taxpayers change their quarterly estimated payments in the first half of CY 2014. The revenue loss to the state General Fund due to the bill is estimated to be $10 M per year beginning in FY 2015. This revenue loss would be attributable to HBI credits for qualified logistics investments.

Industrial Recovery Tax Credit (IR): The bill removes the vacancy duration requirement from the IR credit. Under current statue, 75% of the floor space must be be vacant for at least 1 year to qualify for the credit. Consequently, the bill would expand the potential number of industrial recovery sites across state. In addition, the bill streamlines the application process for the IR credit. Currently, the local governing body must apply to the IEDC before a facility can be eligible for the credit. This bill would allow the IEDC to make that determination on their own. The IEDC estimated that there were 237 potentially available industrial sites across the state. This bill increases the likelihood that more of those sites could qualify for the IR credit.

Between 1988 and 2011, the qualified investments for the IR credit represented only 0.3% of the total structural investment by Indiana manufacturers for the same period. If the changes allow it to be used for 1% of the average annual fixed structural manufacturing investments, it may reduce revenue by an estimated $1.57 M a year beginning in FY 2014. The estimated revenue loss from the expansion of this credit will largely depend on the IEDC's approval process.

Venture Capital Investment Tax Credit: Under current law, the total amount of VCI credits allowed may not exceed $12.5 M in a particular calendar year. This bill permits the total VCI credits claimed by taxpayers to exceed $12.5 M per year as long as the amount of credits approved by the IEDC does not exceed $12.5 M per calendar year. This change will likely have no fiscal impact because historically both the credits certified by the IEDC and the total credits claimed by taxpayers have been well below the $12.5 M annual cap.

Venture Capital Investment Tax Credit Authorization and Use Profile ($ in millions)				
Calendar Year	**Proposed Capital Investment**	**VCI Credits Awarded by IEDC**	**VCI Credits Certified by IEDC**	**VCI Credits Claimed on Tax Returns**
2008	$112.60	$7.80	$6.67	$3.39
2009	71.52	4.98	3.86	2.56
2010	77.47	6.77	4.51	3.38
2011	83.20	2.64	4.17	1.80*
* The 2011 credit amounts are not full-year totals because of filing extensions and suspensions of returns for audit.				

Repealing Tax Credits: The bill repeals the following tax credits:

4. Capital Investment Tax Credit.
5. Coal Combustion Product Tax Credit.
6. Military Base Investment Cost Credit.
7. Military Base Recovery Tax Credit.

Repealing these credits will increase revenue by approximately $14,000 beginning in FY 2015. These tax credits either have extremely low usage compared to the economic activity occurring in Indiana, or there are other credits in place that could potentially be used to stimulate the targeted industry. The revenue estimate is based on average credits claimed between 2005 and 2010 and current credit eligibility and approvals.

Repealing Airport Development Zone (ADZ) Tax Credits: The ADZs will no longer be able to the offer the following credits to taxpayers within ADZ boundaries:

8. Income Earned by ADZ Employees.
9. Employment Expense Tax Credits.
10. Loan Interest Tax Credits.
11. Neighborhood Assistance Credits.
12. Investment Cost Credits.

These credits are the same as the ones employed at the Enterprise Zones. Repealing these credits will increase revenue by about $20,500 beginning in FY 2015. The revenue estimate is based on the historic credits claimed by both individuals and corporations.

<u>Additional Information</u> - *Hoosier Business Investment Tax Credit (HBI):* Under current statute, the HBI credit equals up to 10% of the qualified investments made during the taxable year. The credit percentage is determined by the IEDC. Under the bill, the HBI credit would be computed differently for nonlogistics and logistics investments. The credit allowed under current statute would, under the bill, apply to nonlogistics investments. For logistics investments, the bill would allow the IEDC to grant a credit of up to 25% of the qualified logistics investments made during the taxable year. However, the amount of qualified logistics

investments used to determine the credit is derived by taking the difference of the qualified logistics investments made in the current year and 105% of the average annual qualified logistics investments made in the prior two years. Under the bill, the total amount of HBI credits is limited to $10 M per fiscal year for logistics investments and $50 M per fiscal year for nonlogistics investments.

The credit can be used to offset tax liabilities from the Individual AGI Tax, Corporate AGI Tax, Financial Institutions Tax, and Insurance Premiums Tax. Revenue collected from those taxes are deposited in the General Fund. The credit is nonrefundable, but unused credits may be carried forward for up to nine years. Unused credits may not be carried back.

The U.S. Bureau of Economic Analysis (BEA) provides national data on the amount of fixed private investments by industry type. This information can be used to establish the potential level of investments for which the credit could be claimed. The national data was apportioned to Indiana using the ratio of Indiana GDP to the U.S. GDP. The analysis focused primarily on the transportation and warehousing industrial sectors.

Measure (in millions)	Calendar Year						
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
HBI Credits Offered	$75.8	$26.4	$10.6	$3.6	$2.5	$7.1	$5.8
Total Indiana Private Nonresidential Fixed Investment in Structures*	6,900	8,150	10,130	11,020	8,390	7,150	7,730
Transportation and Warehouse: Indiana Private Nonresidential Fixed Investment in Structures*	454	534	585	585	407	343	354

*U.S. Bureau of Economic Analysis

The annual average level of private fixed investment in structures by Indiana businesses in the transportation and warehousing sector is estimated at $459 M per year between 2000 and 2011. Using the formula from the bill, the average growth during the three positive years was approximately $50.8 M per year. While there were nine years of decline in the aggregate data, individual firms could have increased levels of investments and qualified for an HBI tax credit for logistics improvements. The tax credit for investments in structures alone could potentially be $12.7 M a year. However, the bill caps the maximum amount of logistics-based HBI to $10 M per fiscal year.

The national investment data for nonresidential equipment is not detailed enough to separate creditable expenditures from total equipment investments.

The actual cost of this tax credit is contingent on the IEDC. While HBI was created to provide incentives for capital investments, it does not follow the trend for private nonresidential fixed investments in Indiana. The differing trends could be attributed to the HBI award process. HBI credits are provided after a taxpayer submits an application to the IEDC. The IEDC evaluates the application to determine whether the taxpayer is eligible for the credit and offers an amount of HBI credit based on their evaluation of investments that expand the Indiana workforce. HBI awarded for logistics investments do not have the same evaluation criteria, so it is likely that more logistics credits may be granted.

The bill places two limits on the amount of HBI that can be awarded by the IEDC and claimed by taxpayers. The IEDC can only award a total of $10 M in HBI credits per fiscal year towards qualifying logistics investments and a total of $50 M in nonlogistics investments per fiscal year. However, the caps also apply to the amount of credits that may be claimed per fiscal year. A situation may occur where several taxpayers were legitimately awarded HBI credits, but find themselves unable to claim them. For example, a taxpayer is granted a logistics credit of $5 M in 2014, and they can only claim $2 M for that taxable year. Next year, another taxpayer is granted a logistics credit of $9 M. When filing their returns, one of the taxpayers will not be allowed to claim the full value of their remaining credits because the total will exceed the $10 M per fiscal year limit. This will unlikely be an issue for credits awarded for nonlogistics investments. The average annual amount of credit claimed between 2005 and 2010 was approximately $10.4 M.

<u>*Background Information*</u> - Below are summaries of the tax credits mentioned in the bill.

ADZ Employee Deduction for Earned Income: Individual taxpayers who live and are employed within an ADZ may deduct half of the AGI earned as a qualified employee during the year up to a maximum deduction of $7,500.

ADZ Employment Expense Credit: This credit is for employers that hire qualified employees living in an ADZ and working at least half of the time in the ADZ. The credit is equal to the lesser of 10% multiplied by the qualified increased employment expenditures of the taxpayer for the taxable year; or $1,500 multiplied by the number of qualified employees employed by the taxpayer during the taxable year.

ADZ Investment Cost Credit: This credit is for taxpayers purchasing an ownership interest (an equity investment) in a business located in an ADZ. The credit is equal to a maximum of 30% of the equity investment depending on the type of investment, the type of business, and the number of jobs created.

ADZ Loan Interest Credit: This credit is equal to 5% of the interest a taxpayer receives during the taxable year on qualified loans to businesses or individuals for specified uses in an ADZ.

Capital Investment Credit: This credit is equal to 14% of the value of qualified investment in a project having an estimated total cost of at least $75 M and being located in Shelby County.

Coal Combustion Product Credit: This credit is equal to $2 per ton of increased annual acquisitions of coal combustion products (the byproduct resulting from the combustion of coal in an Indiana facility) obtained by a taxpayer for the manufacturing of recycled components with the byproducts.

Headquarters Relocation Credit: This credit is for a business with at least $100 M in worldwide revenues that relocates its headquarters to Indiana and employs at least 75 employees in Indiana. The credit is equal to 50% of the relocation costs.

Hoosier Business Investment Credit: The credit is for qualified investments that the IEDC determines will foster job creation and higher wages in Indiana. The credit is equal to a percentage determined by the IEDC, not to exceed 10% of the amount of the qualified investment made by the taxpayer.

Industrial Recovery (Dinosaur) Credit: This credit is based on a taxpayer's qualified investment in a vacant industrial facility located in a designated industrial recovery site. The IEDC must approve applications and plans for rehabilitation in order to receive this tax credit. The amount of the credit is equal to the qualified investment made during the taxable year, multiplied by a percentage ranging from 15% to 25% depending on the age of the facility.

Military Base Investment Cost Credit: This credit is for taxpayers purchasing an ownership interest (an equity investment) in a business located on a military base, a military base reuse area, an economic development area, a military base recovery site or a military base enhancement area. The credit is equal to a maximum of 30% of the equity investment depending on the type of investment, the type of business, and the number of jobs created.

Military Base Recovery Credit: This credit is for taxpayers who are owners or developers of military base recovery sites if they invest in the rehabilitation of real property located in a military base recovery site. The IEDC must approve applications and plans for rehabilitation in order to receive this tax credit. The amount of the credit is equal to the qualified investment made during the taxable year, multiplied by a percentage ranging from 15% to 25% depending on the age of the facility.

Venture Capital Investment Credit: This credit is equal to 20% of annual qualified venture capital investment made by a taxpayer up to a maximum credit of $500,000. The IEDC certifies businesses to receive creditable venture capital investment.

Explanation of Local Expenditures:

Explanation of Local Revenues: Local revenue could decrease to the extent that a local unit receives distributions from the Commuter Rail Service Fund or the Industrial Rail Service Fund.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation.

Local Agencies Affected: Airport Development Zones.

Information Sources: U.S. Bureau of Economic Analysis, *Table 5.4.5. Private Fixed Investment in Structures by Type, Table 5.5.5. Private Fixed Investment in Equipment and Software by Type*, *GDP by State: Indiana,* accessed on December 20, 2012, LSA Income Tax Database; LSA, *Indiana Income Tax Credit Study: Hoosier Business Investment Tax Credit,* September 2012; September 2012; Dun & Bradstreet: Million Dollar Database; Eric Shields, IEDC, 317-234-3997; Shane Corbin, Department of State Revenue; U.S. Census Bureau; U.S. Energy Information Administration.

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